

Internal Revenue Service
Director, Exempt Organizations

Department of the Treasury
P.O. Box 2508 - TE/GE Rm 6417
Cincinnati, OH 45201

Date: AUG 01 2002

Employer Identification Number: [REDACTED]

Person to Contact -- I.D. Number: [REDACTED]

Contact Telephone Number: [REDACTED]

Dear Sir or Madam:

We have considered your application for [REDACTED] of exemption from Federal income tax under the provision of section 501(c)(3) of the Internal Revenue Code of 1986 and its Regulations. Based on the available information, we have determined that you do not qualify for the reason stated in the enclosed Notice of Proposed Adverse Action.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code. However, we have concluded that you do not qualify under another subsection.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a Trust, or Form 1120 if you are a corporation or an unincorporated association. Contributions to you are not deductible under section 170 of the Code.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

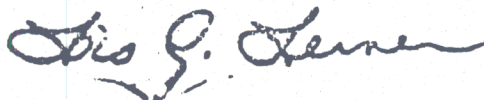
[REDACTED]
[REDACTED]

If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides, in part, that:

A declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within the time specified, this will become our final determination. In that event, appropriate State officials will be notified of this action in accordance with the provisions of section 6104(c) of the Code.

Sincerely,



Director, Exempt Organizations

Enclosures: 3
Enclosure I
Publication 892
Form 6018

Facts

You were incorporated as a not-for-profit corporation [REDACTED].
In your articles of incorporation the purposes of the organization for which you were formed are:

To care for the needs of the poor, the sick, and the needy in the [REDACTED] and in and around [REDACTED]. This includes establishing and operating schools and charitable institutions such as a home for the aged, widows, orphans, alcoholics, drug addicts, and other persons in need of the necessary provisions of life; it includes presenting the Gospel of the Lord Jesus Christ by radio, television, the printed Word, recordings, and by any other means deemed advisable by the board of directors of this corporation.

Your initial registered agent is [REDACTED] and the initial address of the registered office in [REDACTED] is [REDACTED]. The articles of incorporation are signed by [REDACTED], [REDACTED], [REDACTED], [REDACTED], and [REDACTED]. Your board of directors as stated in your application are: [REDACTED], [REDACTED], [REDACTED], [REDACTED], and [REDACTED].

You state that financial support will come from donations, fundraising, tuition and grant writing.

Enclosed in the application file are statements, resolutions and schedules regarding Revenue Procedure 75-50 for private schools. These include: Resolution of the Governing Body, Statement section 4.02, Published Notice of Nondiscrimination, Schedule of Racial Composition, Schedule of Scholarship and Loan Funds section 5.01-2,

ARTICLE VII section 7.3 of your Bylaws shows that your fiscal year end is [REDACTED].

In your application and in statements you submitted with your application you state that you will operate a school named [REDACTED]. The school is located in the home of [REDACTED] and [REDACTED] at [REDACTED]. The school activity is more than 50% of your activities (per initialed statement dated [REDACTED].) [REDACTED] and [REDACTED] are the administrators and the teachers of the school. The school has [REDACTED] students for the current year ([REDACTED].)

You estimate that the school will have [REDACTED] students for the next school year. (see statement dated [REDACTED].) This number was revised for the next school year to [REDACTED] because two students are moving away and

additional students have enrolled. (see statement dated)

For the current school year () two students are related to the teachers and administrators. For the next school year () student will be related to the teachers and administrators. Tuition assistance is being provided to students for the current () school year. Tuition assistance will be provided to children for the next school year ().

is receiving tuition assistance for the current school year, . He is a , and the , both .

is listed as a student for the next school year, . He is . of the organization.

Schedule H was provided to the organization but was returned blank with the following explanation "[t]here are no grants, scholarships, or loans being given, only assistance is used strictly to supplement tuition to " and "[a]s offerings come in, the selection committee selects the applicant which receives the assistance" and "[t]he availability of the assistance is made known, providing funds are available, when an applicant makes it known that they need financial assistance." Also the following statement was submitted "[t]here are no restrictions on and no limitations based upon race, employment, relationship, or religion."

On the agent assigned to process the organization's application discussed the issue of "earmarked" funds with founder and governing body member. She wanted to know if contributions from a business or individual, for example from a grandparent, would be deductible. She described a situation where the contribution would be made specifically for a student in the school.

Law

In *Better Business Bureau of Washington, D.C., Inc. v. United States*, 326 U.S. 279 (1946), the presence of private benefit, if substantial in nature, will destroy the exemption regardless of an organization's other charitable purposes or activities.

Section 501(c)(3) of the Code provides, in part, for the exemption from Federal income tax to organizations organized and operated exclusively for charitable, religious, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a) of the Income Tax Regulations provides that, in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated for one or more of the purposes specified in that section. If an organization fails to meet either the organizational or operational test, it is not exempt.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations asserts that an organization is not operated exclusively for exempt purposes unless it serves a public rather than a private interest. It must not be operated for the benefit of the persons who created it.

Section 501(c)(3) expressly forbids the inurement of net earnings to the benefit of a private shareholder or individual. Section 1.501(c)(3)-1(c)(2) of the Regulation focuses the inurement proscription on those who, by virtue of a special relationship with the organization in question, are able to influence the expenditure of its funds or the use of its assets, rather than on the general public. See, for example, *Church By Mail, Inc. v. Commissioner*, 765 F.2d 1387 (9th Cir. 1985); *est of Hawaii v. Commissioner*, 71 T.C. 1067 (1979).

Gifts by a charitable organization to friends and relatives of persons in control of the organization are personal in nature rather than public. The recipients are natural objects of the donor's bounty. Therefore, by aiding them, the organization is serving the insider's private purposes. This is true even though the recipients may be needy. In *Charleston Chair Company v. United States*, 203 F. Supp. 126 (E.D.S.C. 1962) a large part of a foundation's funds used for scholarship grants to the son of a foundation trustee results in inurement of earnings.

In Revenue Ruling 69-257, 1969-1 CB 151 a nonprofit organization awarding scholarships based on scholastic ability, without regard to financial need, may qualify for exemption under section 501(c)(3) of the Code. The recipients are selected from a broad class of applicants on the basis of scholastic standing only.

Application of Law

Following are several paragraphs that compare and contrast the facts and details of your organization with the court cases and revenue rulings cited above. These expositions are arguments showing in specific circumstances how you are similar or not similar to the relevant law cited. Based upon the details in your application and our judgement regarding the applicable law we have determined that although your purposes may be considered charitable your operational activities promote in more than an insubstantial way other than charitable purposes.

As in *Church By Mail, Inc. v. Commissioner* your organization by virtue of a special relationship between the assisted individuals and your governing body members creates a situation where the related members are in a position to influence the expenditure of the organization's funds or the use of its assets and direct assistance to individuals that are related to themselves. This activity is furthering a private, not a public interest and prevents exempt recognition under section 501(c)(3).

As in *Charleston Chair Company v. United States* your organization is assisting relatives of persons controlling the organization. According to this court ruling, the activity of assisting an individual that is also a relative of an individual that is in a position of control for the organization is described as creating inurement. This situation even though the recipients may be needy is still considered inurement.

In *Better Business Bureau of Washington, D.C., Inc. v. United States* an organization that has more than an insubstantial amount of private benefit does not qualify under Code section 501(c)(3). The information regarding the students attending the [REDACTED] school for the current school year show that [REDACTED] % of the students ([REDACTED] = .[REDACTED]) are related to governing body members. You also state that the school activity is at least [REDACTED] % of your activities. Therefore [REDACTED] % ([REDACTED] x [REDACTED] % = .[REDACTED]) or more of your activity can be characterized as serving a private interest and this is considered substantial which precludes recognition under section 501(c)(3) of the Code.

As in Revenue Ruling 69-257 you are not like this organization because you do not select individuals for assistance from a broad class of applicants. Additionally you have not established that you will use objective and non-biased criteria in selecting individuals. This conclusion is based upon your stated policy to provide assistance "providing funds are available, when an applicant makes it known" and to "anyone attending [REDACTED] who has a need and requests it" and you further state that "[t]here are no restrictions and no limitations based upon race, employment, relationship, or religion."

Applicant's Position

In the response dated [REDACTED] you state "[i]s it the Service's contention that any school that does not operate solely by revenues from tuition payments has 'pre-selected' essentially all of the students because it is charging less than is necessary for the maintenance of the School?" Subsidizing educational activities generally does not prohibit exempt recognition in circumstances where activities serve a public rather than a private interest. The issues for your organization occur in part because the assistance is for

individual students related to members, governing body members and founders.

Your position that "[t]here are no grants, scholarships, or loans being given, only assistance is used strictly to supplement tuition to [REDACTED]" has been considered.

Regardless of what the individual assistance is called it will be considered educational assistance as described in Schedule E for Organizations Providing Scholarship Benefits, Students Aid, etc., to individuals.

You make the statement that "[t]here is no intent on the part of the governing board to provide a private benefit for themselves. To correct this misapprehension, the board has adopted the policy that no relatives of the governing board members are eligible for scholarship or tuition assistance. It is also instructive that the students that are related to the board members are not part of the immediate family. The school was not created or designed to benefit the families of the governing board." We have considered your positions and further advise you that our determinations are based upon activities not intent. Also the facts that have been provided by your organization state that relatives of governing body members are receiving educational assistance. Finally, the law cited in this letter for related individuals includes relatives and friends and does not limit the legal implication to immediate family members.

Conclusion

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code. You are organized for private rather than public purposes within the meaning of section 1.501(c)(3)-1(d)(1)(ii) of the Regulations. You are not operated exclusively for 501(c)(3) purposes because you do not engage primarily in activities that accomplish one or more exempt purposes as specified in section 501(c)(3) of the Code.